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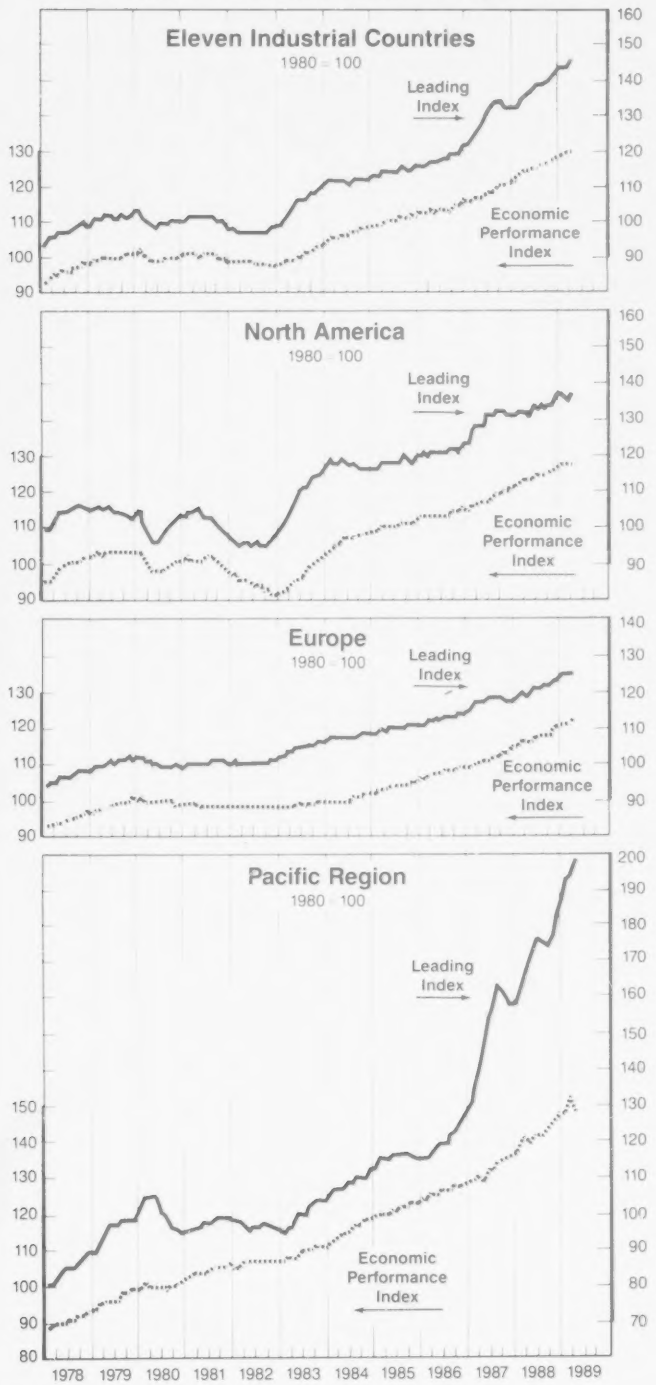
The Conference Board

Economic and Business Environment Program

International Economic Scoreboard

A Quarterly Report from The Conference Board — **Third Quarter 1989**

WORLD BUSINESS CYCLE



Once again the indexes that track the global business cycle seem to be saying that the long expansion of the 1980s just keeps rolling along. This time, however, there is uncertainty whether the economic picture is as strong as the leading index suggests is the case. Most of the vigor in the leading index is supplied by the data from Japan, but (for reasons explained on page 4) the dramatic acceleration in the Japanese index *may* overstate prospects for that economy.

When we look at the other ten major economies, the leading indexes are still climbing, but at a more subdued pace. Including Japan, the 11-country composite leading index is advancing at an 8 percent rate. If we leave Japan out, the leading index would be growing at a more mundane pace of about 3 percent. Furthermore, if we focus only on the latest three months, the global leading index would be barely growing.

This should not be read as a signal of recession ahead. The growth rates are still positive, for the industrial world as a whole and for almost every country separately. But it does indicate a loss of cyclical momentum, a distinct shifting of gears from the steady advances that have been recorded since the stock market crash in late 1987. Thus it does throw up a yellow caution flag. Business cycle analysts will want to be more alert than usual.

(Note that the indexes now include New Zealand as the eleventh country in the global indexes and the fifth country in the Pacific Region.)

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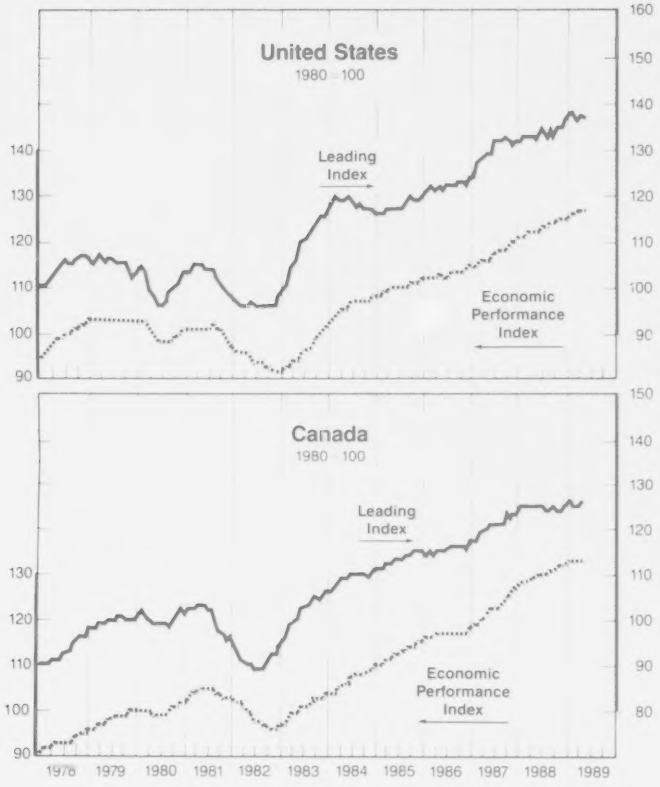
NORTH AMERICAN COUNTRIES



The U.S. economy continues to expand at a steady pace, but the leading index no longer shows an optimistic outlook for further gains. At this point the evidence is too meager to be conclusive, but the leveling off in the leaders since early in the year suggests a slowing of the expansion in the months ahead and perhaps also more moderate inflationary pressures (see essay, pages 5 and 6).

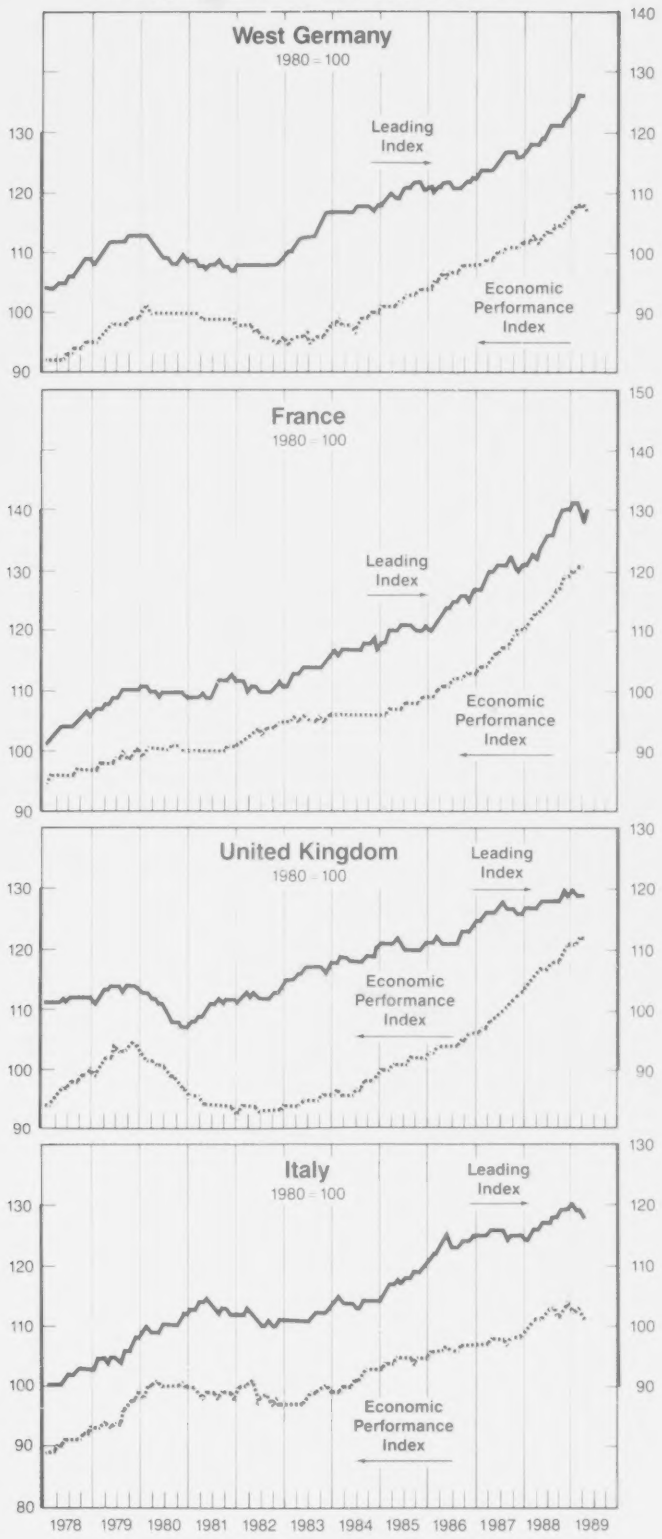
Thus far in 1989, the Canadian indexes look a lot like their U.S. counterparts, except that the sluggishness in the leading index during 1988 makes this year's figures seem a bit more satisfactory.

Summary Of Growth Rates, Eleven Industrial Countries

	Ten-year Growth Rate	Indexes of Economic Performance Growth Rates*			Leading Business Cycle Indexes Growth Rates*			Current Reading on the Cycle	Latest Month Covered
	1976-86	6 mos. ago	3 mos. ago	Latest month	6 mos. ago	3 mos. ago	Latest month		
	annual rates, percent								
Eleven countries	3	5	5	4	5	10	8	Expansion continuing	Apr.
Ten countries excl. U.S.	3	5	6	5	7	12	11	Expansion continuing, leaders strong	Apr.
North America (2)	3	4	4	4	3	5	4	Expansion continuing	Apr.
Europe (4)	2	5	5	4	5	6	3	Expansion continuing	Apr.
Pacific Region (5)	4	6	7	6	10	21	22	Expansion continuing, leaders strong	Apr.
United States	3	4	5	3	4	4	3	Expansion continuing	May
Canada	3	4	4	3	0	1	2	Expansion continuing	Apr.
West Germany	2	4	5	3	5	7	6	Expansion continuing	May/Apr.
France	2	7	8	6	9	6	3	Expansion continuing	Apr./May
United Kingdom	2	6	5	5	1	3	1	Expansion continuing, leaders weak	Apr.
Italy	2	3	1	-2	4	4	1	Downturn may be developing	Apr.
Japan	4	7	6	7	11	24	25	Expansion continuing, leaders strong	May/Apr.
Australia	3	11	11	15	7	4	6	Expansion continuing	Apr./May
Taiwan, R.O.C.	8	10	6	9	14	8	6	Expansion continuing	May
Korea, R.O.K.	7	7	8	3	9	6	5	Expansion continuing	Apr.
New Zealand	2	-4	-5	-1	1	2	3	Upturn developing	Nov./Apr.

* Ratio of current month's index to average index over the preceding 12 months, expressed as a compound annual rate.

EUROPEAN COUNTRIES



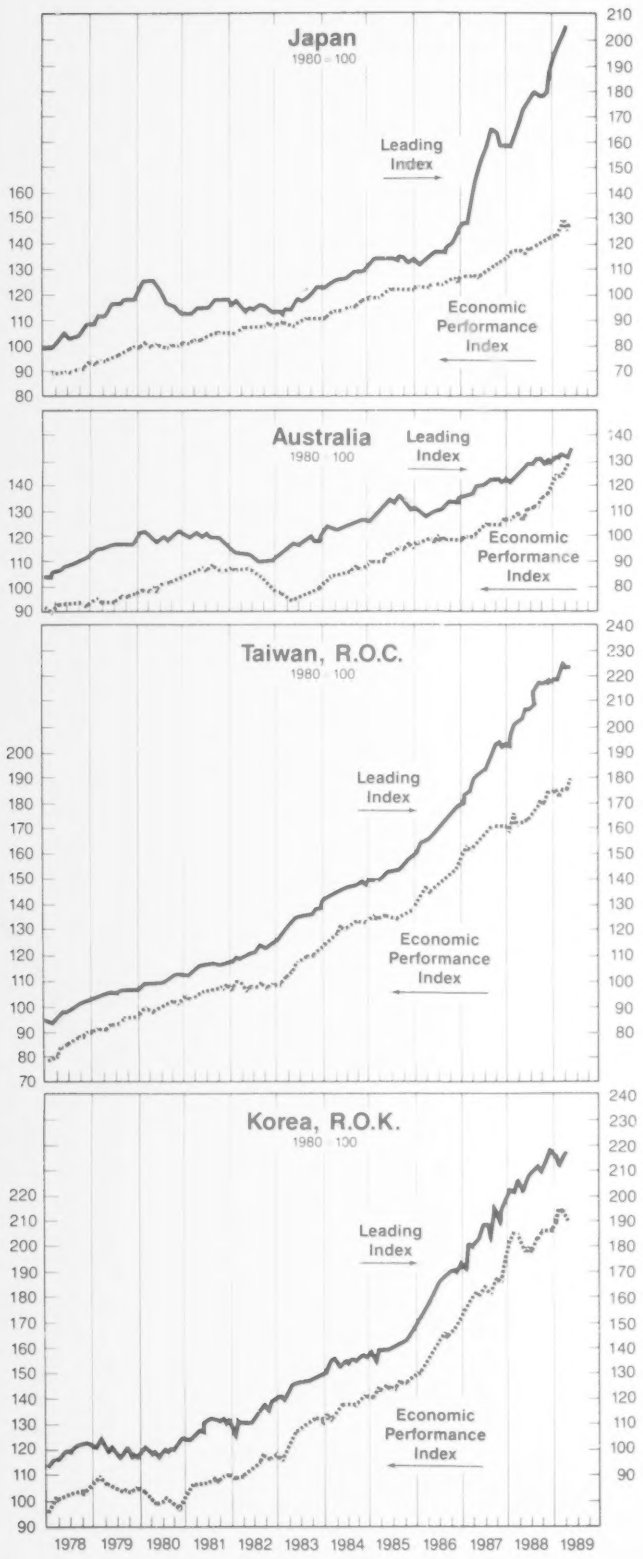
The West German indexes continue to give a good account of themselves, especially the leading index. West Germany is, in fact, the only one of the four major European countries with an unqualifiedly favorable outlook.

In France, the economic performance index continues to climb nicely, but the leading index took quite a tumble in April and only recovered part way in May. The significance of this abrupt drop will remain in doubt for at least another month or two.

Data for the United Kingdom show a continuation of the recent pattern: steady gains for the economy but intermittent sluggishness in the leading index. The higher rates of inflation experienced in the U.K. since late last year have been very unsettling to the outlook.

In Italy, both indexes have fallen abruptly since the turn of the year, for reasons that seem as obscure as ever.

PACIFIC REGION COUNTRIES



The Japanese economy continues to expand briskly. The leading index, moreover, has accelerated dramatically—to a 25 percent growth rate from 18 percent last month and 6 percent two months ago. The sharp acceleration can be traced to two component indicators: inventory investment and net additions to consumer credit. These two series tend to fluctuate erratically from quarter to quarter, and for technical reasons are awkward to handle in calculating the composite leading index. Thus, although the outlook for the Japanese economy remains distinctly favorable, the extraordinary growth of the leading index should not be taken at face value.

The Australian outlook continues to look good. The performance index accelerated to still faster growth and the leading index recovered some of its lost momentum.

In Taiwan, both the economic performance and leading indexes continue to show favorable cyclical trends. Again, the strongest component series among the leading indexes is common stock prices.

Although the Korean leading index is still showing a growth rate of 5 percent, recent movements in both the performance and leading indexes show a noticeable loss of momentum.

Although there wasn't time to prepare a chart, indexes have recently been compiled for New Zealand and have been incorporated into the regional and global indexes shown on page 1. The Kiwis went through a mild recession in 1987-88 (the only industrial country to do so) but the leading index has gradually been moving higher since mid-1988, suggesting that cyclical recovery is underway. (A separate chart for New Zealand will be included in the next quarterly report.)

SIGNALS OF REDUCED INFLATION

There is considerable discussion about the likelihood that during the rest of 1989 economic growth in the United States will be considerably slower than the solid 3.1 percent pace of the four quarters through March. A reduced rate of economic growth would be welcome news for those who are concerned about inflation. A lot of business history in the United States and other countries tells us that economic slowdowns and recessions typically reduce the inflation rate.

In this issue of the *Scoreboard,* we review the relation between growth slowdowns and changes in the U.S. inflation rate. In addition, we examine the prospects for a decline in inflation in the second half of 1989.

Since 1948, there have been 11 economic slowdowns or recessions in the United States. The slowdowns are periods when economic growth is slower than the long-term trend rate of growth. Recessions are periods when economic activity in the aggregate actually falls; hence, by definition, they also can be classified as slowdowns. The accompanying chart shows the movements in the inflation rate (the consumer price index, CPI) during the various phases of the U.S. growth cycle. During each of the slowdowns in real growth (shaded areas) the smoothed inflation rate reached a high and then declined.

To be sure, the cycles in the inflation rate are not synchronous with the growth cycles. Thus, the declines in the rate of inflation do not occur simultaneously with the onset of an economic slowdown. On average, in fact, the peaks and troughs in the smoothed inflation rate lag behind the growth cycle peaks and troughs by close to half a year. Thus we should not expect that a slowdown in U.S. growth will instantly cure our inflation problem.

But the close correspondence between growth cycles and inflation rate cycles tells us that the growth rates presented in the *Scoreboard* can be used to provide early warning signals of a slowdown in inflation. The table on the next page gives the record on this since 1948. The initial signal of a slowdown in growth, and subsequently in inflation, occurs when the leading index growth rate falls below 2.2 percent. The final signal of a slowdown is set off when the performance index growth also falls below 2.2 percent. Comparable signals are used for growth speedups. The average lead of the initial signal over inflation rate peaks was 7 months, while the second peak signal, on average, led the inflation downturn by 2 months.

What do the current figures show? The latest growth rates in the *Scoreboard* are for May, when the leading index growth rate was 2.6 percent and the performance index growth rate was 3.1 percent. Thus neither has hit the 2.2 percent signal level, although they are not far above it. Hence the indexes are not yet proclaiming either a slowdown in the U.S. economy or a drop in the inflation rate, which in May reached its high to date, 5.8 percent. There are, however, other signs that a decline in inflation may be close at hand, including a weakening in the June figures for the leading index of inflation issued by the Center for International Business Cycle Research. So keep watching!

Inflation Rate and Growth Cycles
United States

Note: Shaded areas are growth cycle recessions.

Inflation Peaks and Growth Peak Signals, United States

Inflation Cycle Peak Dates	*Growth Cycle Peak Signal Dates*		*Lead(-) or Lag(+) of signals, in months*	
	Initial	*Final*	*Initial*	*Final*
2/51	4/51	6/52	+ 2	+16
10/53	6/53	8/53	- 4	- 2
8/57	1/56	6/56	-19	-14
10/59	8/59	9/59	- 2	- 1
10/66	5/66	5/67	- 5	+ 7
2/70	5/69	11/69	- 9	- 3
9/74	8/73	12/73	-13	- 9
3/80	1/79	4/79	-14	-11
2/84	7/84	n.s.	+ 5	n.s.
Average Lead(-) or Lag(+), in months			- 7	- 2
Percent Leads			78	75

Note: Inflation cycle peak dates are based on the CPI six-month smoothed rate. Signals are based on the growth rates in the Scoreboard's leading and economic performance indexes. For the initial signal of a peak, the growth rate in the leading index falls below 2.2 percent; for the final signal of a peak the growth rates of *both* the leading and performance indexes fall below 2.2 percent. Initial signals that did not correspond with inflation cycle peaks occurred in 6/62, 1/78, 8/81, 8/86 and 4/88.

n.s. = no signal.

THE INTERNATIONAL ECONOMIC INDICATOR SYSTEM

This publication is designed to help readers monitor the ups and downs of the business cycle around the world. To this end, two types of index are shown for each country: an index of economic performance and a leading index. The economic performance indexes are composites of such series as real GNP, industrial production, employment and sales—what analysts call "coincident" series, because they *define* the business cycle.

The leading indexes are composites of such series as new orders, construction contracts, corporate profits and stock prices—indicators that usually anticipate changes in production and employment by several months. Thus, the indexes of economic performance tell us the current status of the business cycle, i.e., where we are, while the leading indexes tell us where the economy is headed.

Experience has shown that when the leading index begins to rise faster, it is a fairly safe rule that the economy will soon begin to rise faster too—typically after three or four months. When the leading index begins to rise more slowly or to decline, the economy is likely to follow suit shortly thereafter. (For details, see "What the Leading Indicators Indicate," *Across The Board*, April 1980 and *Business Cycles, Inflation and Forecasting*, Ballinger Publishing Co., 1983.) Considerable variation in the length of the lead is to be expected, however. Constant monitoring is needed to make effective use of the system and to get early warnings of recessions and recoveries, changes in foreign trade flows, and new inflationary trends.

The indexes were developed by Geoffrey H. Moore and Philip A. Klein, and are maintained by the Center for International Business Cycle Research at the Columbia Business School. (The U.S. indexes used here differ slightly from the indexes reported monthly by the U.S. Dept. of Commerce.) To facilitate analysis the indexes are adjusted so their long-run growth rates are equal to those in real GNP in the country concerned. These growth rates are shown in the first column of the table on page 2 of the quarterly version of the *Scoreboard*.

For More Information

To find out more about this indicator system and the availability of detailed data for each country please address inquiries to:

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